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**CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS
FOR THE YEAR ENDED
JUNE 30, 2009**

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**CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

For the Year Ended June 30, 2009

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MEMORANDUM ON INTERNAL CONTROL

November 6, 2009

To the City Council of
the City of Roseville
Roseville, California

In planning and performing our audit of the financial statements of the City of Roseville as of and for the year ended June 30, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The City's written responses included in this report have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

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**CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF OTHER MATTERS**

2009-01 INVESTMENT POLICY COMPLIANCE

Condition

As of June 30, 2009, the City held the following investments that were below the minimum credit rating requirements as stated on the City's Investment Policy for fiscal year 2008-2009:

	Minimum Credit Ratings per Policy	Credit Ratings		
		AA-	A+	A
Corporate Notes	AA	\$4,074,739	\$1,046,940	\$1,004,808

We were told by City management that the credit ratings stated on the Investment Policy were meant to provide guidelines for acquisition of investments only. The City believes that the minimum credit rating requirement does not apply to investments that are already in the City's investment portfolio.

Criteria

In order to provide clear guidance to City staff, the intention of the City Council should be clearly stated in the Investments Policy.

Effect

The above investments had credit ratings lower than the minimum rating stated on the Policy.

Cause

We were informed by City management that the above investments met the minimum credit rating requirement when acquired. However, due to the recent economic environment, these investments had been affected in unusual and unanticipated manners which had caused them to slip into credit ratings which were less than the minimum required levels.

Recommendation

The Investment Policy should be revised to clarify when the minimum credit rating requirement applies. Furthermore, the City's Investment Policy does not provide direction on what action the City should take when investments in the City's portfolio fall below the minimum required rating. We recommend the City evaluate those investments monthly and decide the proper course of action, whether that means holding the investment until maturity or selling immediately.

Management Response

The investment policy is in compliance with the California Government Code at the *time of purchase*. The government code does not state what a City must do if the rating dips below the minimum credit threshold. It is the City's practice to review these investments on a monthly basis and take appropriate action, if needed. City staff will amend the current policy for the Council's annual policy adoption and add language regarding investments downgraded below the minimum credit rating.

**CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF OTHER MATTERS**

2009-02 DEBT RESERVE REQUIREMENT

Condition

According to the bond indentures, as of June 30, 2009, the City was required to maintain a total of at least \$20,292,785 in its bond reserve account for the 2002, 2004, 2005A, 2008A, and 2008B Electric System Revenue Certificates of Participation. However, the City's reserve account showed a balance of \$17,769,072 on that date.

Criteria

Required levels of reserves should be maintained in accordance to the debt indentures at all times.

Effect

The City is not in compliance with the above bond covenant requirement.

Cause

We were told by City management that the City's Underwriter for the 2008 Electric System Revenue Refunding Certificates of Participation was responsible for calculating the above debt reserve requirement. Also, the City's Financial Advisor had reviewed the amount provided by the Underwriter to ensure that the City was in compliance with the covenant requirements.

Recommendation

Since the City is ultimately responsible for staying in compliance with the bond reserve requirement, the City should periodically review the balances of its reserve accounts even if a third party is responsible for determining the reserve amounts.

Management Response

The reserve fund requirement uses a three prong test to calculate the minimum requirement and it shall be equal to the lesser of: (i) 10% of the original principal amount of the bonds, (ii) maximum annual debt service or (iii) one hundred twenty-five (125%) of average annual debt service.

Roseville Electric has approximately \$267 million of outstanding bonds consisting of fixed rate, variable rate, and swap structures. When the underwriter provided the calculation to the related parties (UW, City, Bond Counsel, Trustee, Financial Advisor, etc), the three prong test calculation appeared to be correct. Upon further review months later, the City noticed the UW took 10% of a number that was already at 10% and it created a reserve fund shortfall. Bond holders were notified and the City stated the shortfall would be cured with interest earnings and/or a new bond issue. In December 2009, the City refunded the 2002 Electric COPs with the sale of the 2009 Electric Refunding COPs and the shortfall was cured.

The reserve fund requirement is reviewed by the City and Trustee on an annual basis. A spreadsheet consisting of all bond issues with their current reserve fund balances and required reserve balance are listed. This spreadsheet is made available to the auditors during Final review.

CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
SCHEDULE OF OTHER MATTERS

2009-03 NEW PRONOUNCEMENTS:

The following comments represent new pronouncements taking affect in the next few years. We cite them here to keep you abreast of developments:

Statement No. 53 -- Accounting and Financial Reporting for Derivative Instruments (Effective for fiscal 09/10)

This Statement is intended to improve how state and local governments report information about derivative instruments in their financial statements. Specifically, GASB 53 requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting (proprietary and entity-wide financial statements). Governments enter into derivative instruments as investments; as hedges of identified financial risks associated with assets or liabilities, or expected transactions (that is, hedgeable items); or to lower the costs of borrowings. Governments often enter into derivative instruments with the intention of effectively fixing cash flows or synthetically fixing prices. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors, and collars), swaptions, forward contracts, and futures contracts. In addition, this standard addresses hedge accounting requirements.

Statement No. 54 -- Fund Balance Reporting and Governmental Fund Type Definitions (Effective for fiscal 10/11)

This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered **nonspendable**, such as fund balance associated with inventories. This Statement also provides for additional classification as **restricted, committed, assigned, and unassigned** based on the relative strength of the constraints that control how specific amounts can be spent.

The **restricted** fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

The **committed** fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the **assigned** fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds *other than the general fund*, assigned fund balance represents the remaining amount that is not restricted or committed.

Unassigned fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. *In other funds*, the unassigned classification should be *used only to report a deficit balance* resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned. Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

**CITY OF ROSEVILLE
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SCHEDULE OF OTHER MATTERS**

Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

**CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
CURRENT STATUS OF PRIOR YEAR OTHER MATTER**

2008-01 INFORMATION TECHNOLOGY BEST PRACTICES RECOMMENDATIONS

We conducted an Information Systems Review with our audit which encompassed the financial information system and the network environment that houses it. We expanded our work in previous years beyond simply looking at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over the financial system. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever increasing sophistication of hackers and criminals.

Currently, there are no Information Technology standards to which local governments are required to conform. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. We understand the U.S. Department of Justice recommends these for local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

While the results of our work did not indicate material weaknesses, we noted a few areas which could be improved to conform to NIST guidelines. A summary of these recommendations which we believe are "best practices" are as follows:

Payment Card Industry Compliance

The City processes credit cards using point-of-sale systems. Any organization that processes credit cards is required to comply with the Payment Card Industry Data Security Standard (PCI-DSS), even if the processing is outsourced. The standard was developed to minimize the risk of loss due to security breaches in processing credit card transactions. Merchants which conform to the Standard pay lower transaction fees and minimize their liabilities which may result from security breaches than those that do not comply. The Standard requires varying levels of controls depending on transaction levels. In general, merchants must:

1. Fill out a self-assessment questionnaire (SAQ).
2. Submit the SAQ to acquiring banks.
3. Perform quarterly external network scans and submit the results to acquiring banks.
4. Have a full independent PCI audit performed by a Qualified Security Assessor (QSA) and submit it to acquiring banks. (Required for level 1 merchants only).

CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
CURRENT STATUS OF PRIOR YEAR OTHER MATTER

We believe the City qualifies as a Level 3 or 4 merchant due to activity levels of less than 1 million transactions and currently it need only complete and maintain the SAQ in-house. However, we understand SAQ submissions will become mandatory for Level 3 and 4 merchants in the near future. Staff has not completed the SAQ, but should do so and prepare for the submission requirement.

Audit/Event Logging

The City does not appear to have audit logs on the financial application server, such that any change, addition or deletion of user accounts within the application are tracked and monitored. The City should have audit/event logs of any addition, deletion or change in financial application user accounts and that log should be monitored by someone without the rights to effect such changes. In addition, any administrative access such as upgrades or application modifications by IT personnel, outside consultants or vendors should also be logged and reviewed.

General Information Systems Controls

We reviewed the compliance of the City's information systems with the National Institute of Standards and Technology (NIST) information security standards based on a moderate risk system. We noted a number of controls that did not appear to be in place. A separate report of those controls was provided to the City's IT and Finance personnel. We recommend the City choose an appropriate industry standard like NIST to help plan, organize and review information security. In lieu of this selection, we recommend the City continue with the controls that we found in place during our review and review and implement the list of controls that we have provided to management.

Current Status

PCI-DSS Compliance – In the City's credit card process review, the City identified an application version that is not compliant with PCI-DSS. The latest version of this application is PIC-DSS compliant and the City has a project plan to implement this version in the second quarter of 2010.

Audit/Event Logging – The IT Systems Software Manager files reports on changes to the financial application security. The financial application user accounts are currently under review and will conform to an enhanced security structure in the second quarter of 2010.

General Information Systems Controls – IT plans to identify an industry security standard to enforce by the first quarter of 2010 and begin implementation in the second quarter of 2010. The City expects that the security standard will address control areas in question by the first quarter of 2011.

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CITY OF ROSEVILLE

REQUIRED COMMUNICATIONS

November 6, 2009

To the City Council of
the City of Roseville
Roseville, California

We have audited the financial statements of the City of Roseville as of and for the year ended June 30, 2009 and have issued our report thereon dated November 6, 2009. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2009.

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2009.

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are fair values of Investments.

- *Estimated Fair Value of Investments:* As of June 30, 2009, the City, held approximately \$650 million of cash and investments, as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2009. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2009.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

Difficulties: We encountered no serious difficulties in dealing with management relating to the performance of the audit.

Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us, but not recorded by the City, that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process.

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the audit committee.

This report is intended solely for the information and use of the City Council, its committees, and management and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates